

**ARIZONA PROPERTY AND CASUALTY
INSURANCE GUARANTY FUND**

2017 ANNUAL REPORT

REPORT FROM THE CHAIR OF THE BOARD OF DIRECTORS

On behalf of the Arizona Property and Casualty Insurance Guaranty Fund ("APCIGF"), I am pleased to present the 2017 Annual Report. This report is prepared and submitted pursuant to A.R.S. § 20-678.

The APCIGF Board of Directors met twice in 2017, on March 14 and again on October 26, the Annual Meeting, at which officers were elected and standing committees were appointed.

There was one new insolvency case in 2017 for which APCIGF was activated. Castlepoint National Insurance Company, a California domiciled company, was ordered into liquidation effective April 1, 2017. APCIGF received 2 auto claims, 2 liability claims and 39 workers' compensation claims from this insolvency.

In 2017, APCIGF paid \$393,660 in claim settlements and loss adjustment expenses with respect to the Auto Account and the All Other Account. APCIGF paid \$11,067,821 in Workers' Compensation benefits, \$446,969 in Workers' Compensation loss adjustment expenses and \$1,026,321 in Workers' Compensation claim processing fees.

Member insurers are subject to two types of assessments from APCIGF: Class A and Class B. Class A assessments provide for administrative and operating expenses of APCIGF and may not exceed \$200 per member insurer per year. Class B assessments provide for the payment of policyholder claims. Class B assessments are pro rata and may not exceed one percent (1%) of the net direct premium written by a member insurer for each account. No Class A or Class B assessments were levied on member insurers in 2017.

APCIGF is a member of and works closely with and through the National Conference of Insurance Guaranty Funds ("NCIGF") with respect to multi-state insurer insolvencies. Representatives of APCIGF are active on NCIGF insolvency coordinating committees and general committees. Membership and participation in NCIGF helps APCIGF achieve efficiencies in performing its statutory duties that would not be possible acting on its own.

APCIGF uses all of the tools at its disposal to protect Arizona resident insureds and claimants in the unfortunate event of insurer insolvency, acting with transparency and due diligence in regard to its finances and operational matters.

DESCRIPTION OF THE GUARANTY FUND AND ITS BOARD OF DIRECTORS

The Arizona Property and Casualty Insurance Guaranty Fund ("APCIGF") was created in 1977 by the Arizona legislature. APCIGF is within the Arizona Department of Insurance and is governed by A.R.S. §§ 20-661 through 20-680.

The purpose of APCIGF is to protect Arizona resident insureds and claimants in the unfortunate event of the insolvency of a member insurance company that is licensed to write property, casualty, liability or workers' compensation business in Arizona.

APCIGF is responsible for providing a defense to Arizona insureds and paying the claims of insureds and third parties, subject to the terms of the policy and statutory limitations on benefits.

When a court finds that an insurance company is insolvent and orders that it be liquidated, a receiver takes control of the insurer under the court's supervision and liquidates the insurer's assets. APCIGF is activated upon the entry of a final order of liquidation and begins the process of handling the remaining claims of the insolvent insurer in Arizona. APCIGF becomes a creditor of the insolvent insurer to the extent of the payments it makes to or on behalf of policyholders. When the assets of the insolvent insurer allow, the liquidator may distribute money to the affected guaranty funds to assist with the funding of claim payments. This process is called "early access." APCIGF typically recovers a portion of the costs of handling and paying claims from the estate of the insolvent insurer through interim and final distributions. If additional funds are needed to pay claims, APCIGF's Board of Directors may levy an assessment on member insurance companies.

An insurance company becomes a member insurer of APCIGF by operation of law upon becoming licensed to write a line of business for which coverage is provided by APCIGF. Some lines of business are excluded from coverage by APCIGF, such as title insurance, surety, credit insurance, mortgage guarantee, ocean marine, insurance of warranties or service contracts and any business written on a surplus lines ("non-admitted") basis.

APCIGF is governed by a Board of Directors of up to eleven members appointed by the Governor upon recommendations made by the Director of Insurance, including one member representing the public and one member that is a licensed property/casualty producer. Day to day operations are managed by an Executive Director and support staff.

BOARD OF DIRECTORS

Chair

Sara M. Begley, Esq., CPCU
Executive Vice President, General Counsel &
Chief Compliance Officer
Copperpoint Insurance Company
Phoenix, AZ
Current term expires August 27, 2019

Vice Chair

Ronald E. Malpiedi
Vice President and Chief Operating Officer
Mutual Insurance Company of Arizona
Phoenix, AZ
Current term expires August 27, 2020

Secretary

Noel Cole Young, Esq.
Regional Counsel
Allstate Insurance Company
Tempe, AZ
Current term expires August 27, 2018

Treasurer

Paul H. Matson
Director
Arizona State Retirement System
Phoenix, AZ
Current term expires August 27, 2020

Charles P. Breitstadt, JD, CPCU, CLU, FLMI
Director of Government Affairs
Nationwide Insurance
Columbus, OH
Current term expires August 27, 2018

GOVERNANCE

APCIGF's activities and operations are governed by its enabling act, which may be found at A.R.S. §§ 20-661 – 20-680, a Plan of Operation, developed by the Board of Directors and approved by the Director of Insurance, and an Investment Policy, also developed by the Board of Directors and approved by the Director of Insurance. Both the Plan of Operation and Investment Policy are amended from time to time as determined necessary and appropriate by the Board of Directors.

**ARIZONA PROPERTY AND CASUALTY
INSURANCE GUARANTY FUND**

**STATEMENT OF CASH RECEIPTS, DISBURSEMENTS,
AND CHANGES IN CASH AND INVESTMENT
BALANCES AND INDEPENDENT AUDITORS' REPORT**

YEAR ENDED DECEMBER 31, 2017

John C. Todd II, P.C.
Certified Public Accountants

Member
American Institute of CPAs
Arizona Society of CPAs
Government Audit Quality Center

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Independent Auditors' Report

The Board of Directors
Arizona Property and Casualty Insurance Guaranty Fund

Financial Statements

We have audited the accompanying statement of cash receipts, disbursements, and changes in cash and investment balances of Arizona Property and Casualty Insurance Guaranty Fund (Fund), a division of the Arizona Department of Insurance, for the year ended December 31, 2017, and the related notes to the financial statement, which collectively comprise the Fund's basic financial statement as listed in the table of contents.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the modified cash basis of accounting as described in Note 1; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to error or fraud.

Auditors' Responsibility

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

**ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2017**

This section of the Arizona Property and Casualty Insurance Guaranty Fund's (the "Fund") annual report presents management's discussion and analysis of the Fund's financial performance during the year ended December 31, 2017. This section of the report should be read in conjunction with the Fund's financial statements.

FINANCIAL HIGHLIGHTS

- As of the close of the current fiscal and calendar year, the Fund reported an ending Fund Balance of \$228,649,786.
- There were two new insolvency cases in 2017 for which the Fund was activated. Castlepoint National Insurance Company, a California domiciled insurer and formerly the Tower Group of companies, was ordered into liquidation on April 1, 2017. The company wrote commercial lines including workers' compensation insurance. Guarantee Insurance Company, a Florida domiciled insurer, was ordered into liquidation on November 27, 2017. The company wrote primarily workers' compensation insurance.
- No assessments on member companies were levied in 2017, and there were no refunds to member insurers.
- Total receipts for the year were \$2,617,144:
 - Receivership distributions to the Fund totaled \$465,967.
 - Early access distributions to the Fund totaled \$371,961.
 - Gain on the Fund's investments for the year was \$266,270 (net of amortization/accretion and unrealized gains).
 - Gain on the Fund's investments - WC for the year was \$1,512,946 (net of amortization/accretion and unrealized gains).
- Total disbursements for the year were \$13,663,858.
 - The Fund paid \$393,660 in claims settlements and loss adjustment expenses for the Automobile Insurance Account and All Other Insurance Account.
 - The Fund paid \$11,524,582 in workers' compensation claims settlements and loss adjustment expenses.
 - The Fund paid administrative expenses of \$1,745,616.
- Net receipts for the year were (\$11,046,714).

**ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2017**

FINANCIAL ANALYSIS OF THE FUND (CONT'D)

The Fund maintains four accounts pursuant to A.R.S. § 20-662, an Automobile Insurance Account, an All Other Insurance Account, a Workers' Compensation Account and an Administrative Account. As of December 31, 2017, the balance in the Administrative Account was \$2,261,828, a decrease of \$119,796 from the prior year. The balance in the Automobile Insurance Account was \$19,415,753, an increase of \$76,405 from the prior year. The balance in the All Other Insurance Account was \$10,806,163, a decrease of \$154,466 from the prior year. The balance in the Workers' Compensation Account was \$196,166,042 a decrease of \$10,848,857 from the prior year. The Fund's assessment capacity for 2017 was \$48.4 million for the Automobile Insurance Account, \$30.4 million for the All Other Insurance Account and \$8.7 million for the Workers' Compensation Account.

CURRENT KNOWN FACTS, DECISIONS OR CONDITIONS

The property/casualty insurance industry has experienced an extended soft market phase of the underwriting cycle, particularly with regard to commercial lines. History has shown that insolvencies tend to be most likely to occur a year or more into the hard market phase of the underwriting cycle. Catastrophic losses, as a result of natural disasters or manmade events, may also trigger insolvencies. Recent years have produced a few new insurer insolvencies, but nothing approaching the level of activity that occurred from 2001-2005.

While it is impossible to know when insolvencies will occur, or how much in liabilities the Fund will be expected to pay as a result of future insolvencies, considering the Fund Balance at year end of over \$228 million and the Fund's current assessment capacity of over \$87 million, the Fund is well-positioned to handle its current claim liabilities and claim liabilities from new insolvencies.

CONTACTING THE FUND'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Fund's finances. If you have questions about this report or need additional financial information, please contact the Fund's Executive Director at 2910 North 44th Street, Suite 210, Phoenix, Arizona 85018, (602) 364-3863, or msurguine@azinsurance.gov.

ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND
CHANGES IN CASH AND INVESTMENT BALANCES
YEAR ENDED DECEMBER 31, 2017

| | |
|---|------------------------------|
| Cash Receipts: | |
| Early access | \$ 371,961 |
| Receivership distributions | 465,967 |
| Interest income | 440,679 |
| Interest income - WC | <u>2,790,442</u> |
| Total cash receipts | 4,069,049 |
| Cash Disbursements: | |
| Automobile insurance expense | 166,156 |
| Unearned worker's compensation premium returns | 9,792 |
| Workers' compensation insurance loss | 11,067,821 |
| Workers' compensation insurance expense | 446,969 |
| Loss adjustment expense | 227,504 |
| Administrative expenses | <u>1,745,616</u> |
| Total cash disbursements | 13,663,858 |
| Cash receipts in excess of cash disbursements | (9,594,809) |
| Change in Investments: | |
| Amortization/accretion of investments | (142,304) |
| Amortization/accretion of investments - WC | (846,177) |
| Net realized/unrealized gain (loss) on investments | (32,105) |
| Net realized/unrealized gain (loss) on investments - WC | <u>(431,319)</u> |
| Total change in investments | <u>(1,451,905)</u> |
| Total changes in cash and investments | (11,046,714) |
| Cash and investment balance at January 1, 2017 | <u>239,696,500</u> |
| Cash and investment balance at December 31, 2017 | <u><u>\$ 228,649,786</u></u> |

See accompanying notes to basic financial statements.

ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity - The Arizona Property and Casualty Insurance Guaranty Fund (Fund), a division of the Arizona Department of Insurance, was established by the Arizona legislature in 1977 to provide funds for the payment of contractual obligations under certain property and casualty insurance contracts of insolvent insurance companies in accordance with *Arizona Revised Statutes, Title 20, Chapter 3, Article 6*.

The Fund is managed by an eleven-member board of directors appointed by the Governor of the State of Arizona and is under the immediate supervision of an executive director. In order to provide the monies necessary to carry out the powers and duties of the Fund, the board of directors determines the amount and timing of assessments to be made upon member insurers. Member insurers are those individuals or companies authorized to transact the covered types of insurance in the State of Arizona.

Basis of Accounting – Basis of accounting refers to when revenues and expenditures/expenses are recognized in the accounts and reported in the financial statement. The financial statement is presented on the modified cash basis of accounting, which is a special purpose framework of accounting. Under the modified cash basis, revenues are recognized when received rather than when earned and expenses are recognized when paid rather than when the obligation is incurred. Changes in the fair value of investments and reductions in premiums/discounts relating to investments held by the Fund are also included. In addition, all items including the acquisition of furniture and equipment are expensed as paid and receivables, prepaids, payables and accrued expenses are not reported. Accordingly, the financial statement is not intended to present financial position and results of operations in conformity with U.S. generally accepted accounting principles.

Cash and Investments – Cash includes amounts in demand deposits as well as short-term investments with an original maturity date within three months of the date acquired by the Fund. Investments are carried at fair value. Changes in fair value and amortization of premiums/discounts relating to investments held by the Fund are reported as changes in investment balances.

Income Taxes – The Fund operates as a tax-exempt organization for federal and state income tax purposes under Section 115 (1) of the Internal Revenue Code; however, a determination letter has not been requested from the Internal Revenue Service.

Subsequent Events – The Fund has reviewed all subsequent events through May 1, 2018, which was the date the financial statements were available to be issued.

ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2017

NOTE 2 – CASH AND INVESTMENTS (CONT'D)

Interest Rate Risk – The Fund's investment policy for Auto and other accounts requires an average duration to not exceed 1 year and a maximum final maturity on an individual investment shall not exceed 4 years. For workers' compensation accounts, the policy requires an average duration not to exceed 2 years and a maximum final maturity on an individual investment not to exceed 4 years. At December 31, 2017, the Fund had the following investments in debt securities:

| Investment Type | Amount | Weighted Average Maturity in Months |
|------------------------------------|-----------------------|--|
| U. S. Treasury bills | \$ 193,014,879 | 21.1 |
| U. S. Government agency securities | 33,365,500 | 29.7 |
| | <u>\$ 226,380,379</u> | |

NOTE 3 – FUND BALANCES

The Fund maintains four restricted accounts for purposes of reporting cash receipts and disbursements. In accordance with Arizona State statutes, except for the workers' compensation account, the Fund may transfer amounts between accounts. The balances for each account as of December 31, 2017 are as follows:

| | |
|-------------------------------|-----------------------|
| Automobile insurance account | \$ 19,415,753 |
| Workers' compensation account | 196,166,042 |
| Other insurance account | 10,806,163 |
| Administrative account | <u>2,261,828</u> |
| | <u>\$ 228,649,786</u> |

NOTE 4 – COMMITMENTS AND CONTINGENT LIABILITIES

Operating Lease – The Fund rents office space from the State of Arizona, Department of Insurance. Although the Fund has no formal lease agreement related to this office space, the Fund may not relocate without prior authorization from the State. Rent expense on this office space for 2017 was \$16,600.

Litigation – In the course of performing its statutory duties with respect to impaired insurers, the Fund is subject to litigation. It is the opinion of management that such matters will not have a significant or adverse impact on the Fund's financial position.

ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2017

NOTE 5 – RETIREMENT PLAN (CONT'D)

Benefits Provided (Cont'd)

Retirement benefits for members who joined the ASRS prior to September 13, 2013, are subject to automatic cost-of-living adjustments based on excess investment earning. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member's death. For retired members, the retirement benefit option chosen determines the survivor benefit. For all other members, the beneficiary is entitled to the member's account balance that includes the member's contributions and employer's contributions, plus interest earned.

Contributions - In accordance with state statutes, annual actuarial valuations determine active member and employer contribution requirements. The combined active member and employer contribution rates are expected to finance the costs of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the year ended June 30, 2017, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.48 percent (11.34 percent for retirement and 0.14 percent for long-term disability) of the members' annual covered payroll, and the Fund was required by statute to contribute at the actuarially determined rate of 11.48 percent (10.78 percent for retirement, 0.56 percent for health insurance premium benefit, and 0.14 percent for long-term disability) of the active members' annual covered payroll.

ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND
SCHEDULE OF ADMINISTRATIVE EXPENSES
YEAR ENDED DECEMBER 31, 2017

| | |
|--|---------------------|
| Staff salaries and employee related expenses | \$ 226,901 |
| Workers' compensation claims processing | 1,026,321 |
| Dues and subscriptions | 80,190 |
| Dues and subscriptions - WC | 8,649 |
| Legal services | 35,115 |
| Claims processing computer program expense | 36,000 |
| Rent | 16,600 |
| Financial audit service | 5,255 |
| Investment fees | 36,545 |
| Investment fees - WC | 230,638 |
| Telephone | 6,710 |
| Office supplies and expense | 17,697 |
| Banking service fees | 7,071 |
| Travel | 7,293 |
| Conferences and seminars | 1,840 |
| Postage | 770 |
| Board members expense | 2,021 |
| | <hr/> |
| | <u>\$ 1,745,616</u> |